No. 80-780

DEC 16

MICHAEL RODAK,

In the Supreme Court of the United States

OCTOBER TERM, 1980

ROWAN COMPANIES, INC., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES

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QUESTION PRESENTED

Whether meals and lodging furnished by petitioner without charge to its employees while they were working on offshore oil rigs constituted "wages" for social security (FICA) and federal unemployment insurance (FUTA) tax purposes.

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The order of the district court (Pet. App. 13a) is not reported. The opinion of the court of appeals (Pet. App. 1a-12a) is reported at 624 F. 2d 701.

JURISDICTION

The judgment of the court of appeals was entered on August 22, 1980 (Pet. App. 1a). The petition for a writ of certiorari was filed on November 14, 1980. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of Sections 3121(a) and 3306(b) of the Internal Revenue Code of 1954 (26 U.S.C.) are set forth at Pet. App. 14a-15a.[1] The relevant portions of Section 31.3121(a)-1(f) and of Section 31.3306(b)-1(f) of the Treasury Regulations on Employment Tax (1954 Code) (26 C.F.R.) are set forth at Pet. App. 16a-17a.

STATEMENT

1. During the years at issue (1967-1969), petitioner contracted with other firms to drill oil and gas wells both on land and beneath offshore waters. When drilling offshore, petitioner would move its rig to the owner's location, which was often as much as 60 miles from land. The rig was operated by a drilling crew that typically included from four to twelve persons. Each offshore rig operated 24 hours a day and was manned by two crews, each of which worked a 12-hour shift. Members of a crew usually remained offshore for a ten-day tour of duty aboard the rig, followed by a five-day

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[1]Section 3121(a) is derived from Section 811(a) of the Social Security Act of 1935, ch. 531, 49 Stat. 639, and is now part of the Federal Insurance Contribution Act (FICA). Section 3306(b) is derived from Section 907(b) of the Social Security Act of 1935 (49 Stat. 642), and is now part of the Federal Unemployment Tax Act (FUTA).

period of leave. When a crew's new tour commenced, petitioner provided transportation to the offshore location (Pet. App. 2a).

Because of the high cost of transporting crews to and from land at the beginning and end of each shift, petitioner engaged a caterer to provide meals and maintain living quarters for crews working offshore. The eating facilities, sleeping quarters and lounge areas used for leisure activities while a crew was off duty were usually located on a vessel moored alongside the drilling platform (Pet. App. 2a).

Petitioner's decision to provide meals and lodging to its offshore rig employees was unilateral and based upon its own economic reasons. It was not a result of either individual or collective bargaining. Petitioner furnished identical meals and facilities to all employees regardless of their status or rate of pay. An employee who for any reason did not elect to eat meals furnished did not receive an allowance in lieu of the meals (Pet. App. 2a).

Petitioner did not include the value of the meals and lodging in the employees' wage base for purposes of computing the amount of social security (FICA) taxes to be paid by it and the employee and the amount of unemployment insurance (FUTA) taxes to be paid by it. Upon examination of petitioner's tax returns for 1967-1969, the Internal Revenue Service added the fair market value of the meals and lodging in the FICA and FUTA wage bases of the offshore rig employees.[2] After paying the resulting deficiencies, petitioner brought this refund suit in the United States

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[2]The Service did not include the value of the meals and lodging in the employees' wage base for income tax withholding purposes because it determined that these privileges were extended to the employees for petitioner's convenience and were therefore excludable from the employees' gross income under Section 119 of the Internal Revenue Code of 1954. Section 119 provides that an employee's gross income

District Court for the Southern District of Texas (Pet. App. 3a). The district court granted summary judgment for the government (Pet. App. 13a).

2. The court of appeals affirmed (Pet. App. 1a-12a). It first observed that the term "wages" for purposes of FICA and FUTA is broadly defined as "all remuneration for employment, including the cash value of all remuneration paid in any medium other than cash." See 26 U.S.C. 3121(a), 3306(b). The court then noted that since 1940, the Commissioner's Regulations have excluded from wages facilities or privileges of relatively small value furnished employees by the employer, but have included meals or lodging furnished to seamen or other employees aboard vessels. See Treasury Regulations on Employment Tax, Sections 31.3121(a)-1(f), 31.3306(b)-1(f) (26 C.F.R.) (Pet. App. 4a-5a).

The court of appeals upheld the Regulations as consistent with the statute. In so ruling, the court followed similar decisions upholding the FICA and FUTA Regulations in *Pacific American Fisheries, Inc.* v. *United States*, 138 F. 2d 464 (9th Cir. 1943); and *S.S. Kresge Co.* v. *United States*, 379 F. 2d 309 (6th Cir. 1967) (Pet. App. 6a). The court noted that such meals and lodging furnished for the convenience of the employer are excluded from "wages" for purposes of income tax withholding, but held that this

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does not include the value of employer-furnished meals or lodging as long as such meals and lodging are furnished for the convenience of the employer and on the employer's premises. Because the value of such meals and lodging was excluded from gross income, it was not part of the employees' "wages" base for purposes of income tax withholding. Section 31.3401(a)-1(b)(9) of the Treasury Regulations on Employment Tax (26 C.F.R.), specifically excludes from "wages," for purposes of computing income tax withholding, amounts that are not included in an employee's gross income. There are no similar exclusions in the FICA and FUTA Regulations.

exclusion does not in any way qualify the FICA and FUTA definition of wages. The court of appeals accordingly distinguished *Central Illinois Public Service Co.* v. *United States*, 435 U.S. 21 (1978), which involved income tax withholding on an employer's reimbursement for lunch expenses of employees. As the court stated, "a rationale is not difficult to surmise. The purpose of withholding is to set aside the amount needed for income tax. If income tax is not due on some payments to employees, it is unnecessary to withhold taxes from these payments" (Pet. App. 7a).

The court of appeals acknowledged that its decision conflicts with *Hotel Conquistador, Inc.* v. *United States*, 597 F. 2d 1348 (Ct. Cl. 1979), cert. denied, 444 U.S. 1032 (1980), and *Oscar Mayer & Co.* v. *United States*, 623 F. 2d 1223 (7th Cir. 1980), which respectively held that the value of meals furnished hotel and restaurant employees and company cars to employees for below-cost personal use are not "wages" for purposes of FICA and FUTA. However, the court rejected the central premise of the Court of Claims and the Seventh Circuit in those cases that if an item is excludable from "wages" for income tax withholding purposes, it is likewise excludable for FICA and FUTA tax purposes. The court below was "unable to subscribe to [the] conclusion * * * that the same words used in different statutes must mean the same thing and that, therefore Congress intended to deny interpretative power to the Secretary (Pet. App. 11a).

DISCUSSION

1. The court of appeals correctly held that the meals and lodging petitioner furnished its offshore rig employees are includable in their "wages" for purposes of the social security (FICA) and unemployment insurance (FUTA) taxes.

Sections 3121(a) and 3306(b) of the Internal Revenue Code of 1954 broadly define "wages" for purposes of FICA

and FUTA tax provisions as "all remuneration for employment, including the cash value of all remuneration paid in any medium other than cash * * *." These employment taxes were enacted in 1935 as part of the Social Security Act, ch. 531, 49 Stat. 620, in order to provide old age, disability, and unemployment benefits to workers.[3] To accomplish this purpose, Sections 3101, 3111 and 3121(a) of the Internal Revenue Code of 1954 imposed a tax (FICA) on both employers and employees, equal to stated percentages of the "wages."[4] Under Title II of the Social Security Act (42 U.S.C. 401 *et seq.*), the Internal Revenue Service regularly reports to the Social Security Administration the amount of each employee's "wages" on which taxes have been paid. That amount serves as the basis for computing each employee's old age and disability benefits. See *United States* v. *Silk*, 331 U.S. 704, 711 (1947). During the years at issue, unemployment taxes (FUTA) were also imposed solely on employers with respect to the first $3,000[5] of "wages" paid to their employees (Section 3306(b)).

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[3]The old age and disability tax provisions of Title VIII of the Social Security Act of 1935, and the unemployment compensation tax provision of Title IX of the Act, were recodified as Chapter 9 of the Internal Revenue Code of 1939. H.R. Rep. No. 6, 76th Cong., 1st Sess. 3-4 (1939). These Social Security taxes were then incorporated into Subtitle C of the Internal Revenue Code of 1954, as the Federal Insurance Contributions Act and the Federal Unemployment Tax Act.

[4]The FICA tax was originally imposed on the first $3,000 of each employee's annual wages. Section 811 (49 Stat. 639). As of 1980, the tax is imposed on the first $25,900 of annual wages. In 1981, the tax and benefit base will be increased to $29,700. Pub. L. No. 95-216, Section 103(b)(2), 91 Stat. 1513.

[5]Originally, the tax was imposed on the entire year's wages. Sections 901, 907 (49 Stat. 639, 642). As of 1978, the tax is imposed on the first $6,000 of annual wages. Pub. L. No. 94-566, Section 211(a), 90 Stat. 2676.

In enacting the social security taxes, Congress intended to impose the excises on a broad range of employer-furnished remuneration. The Committee Reports state that wages include compensation for services paid in any form, such as room or board. H.R. Rep. No. 615, 74th Cong., 1st Sess. 3 (1935); S. Rep. No. 628, 74th Cong., 1st Sess. 49 (1935). Thus, since 1940, the FICA and FUTA Regulations have defined "wages" to mean "all remuneration for employment," even if such remuneration is furnished for the "convenience of the employer" and is thereby excluded from "wages" for federal income tax withholding purposes under Sections 119 and 3401 of the Internal Revenue Code of 1954.[6] The fact that items of compensation may be includable in the "wages" base for FICA and FUTA tax purposes even though excludable from gross income for income tax purposes is consistent with the broad social welfare goals of the Social Security program. See *Social Security Board* v. *Nierotko*, 327 U.S. 358 (1946); *United States* v. *Silk, supra; S.S. Kresge Co.* v. *United States*, 218 F. Supp. 240, 243 (E.D. Mich. 1963); H.R. Rep. No. 615, 74th Cong., 1st Sess. 21 (1935). The Regulations specify that, for Social Security tax purposes, the value of meals or lodging furnished by an employer ordinarily constitutes taxable "wages." For purposes of this case, the pertinent

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[6]See S.S.T. 383, 1940-1 Cum. Bull. 210; Mim. 5657, 1944 Cum. Bull. 550; and Rev. Rul. 57-471, 1957-2 Cum. Bull. 630, all explaining Treas. Reg. 106, § 402.227 (1940 ed.) (FICA) and Treas. Reg. 107, § 403.227 (1940 ed.) (FUTA). These Regulations were carried forward substantially unchanged in Treas. Reg. 128, § 408.226 (1951 ed.). The current Regulations were promulgated in 1956. T.D. 6190, 1956-2 Cum. Bull. 605, 619 (FICA); T.D. 6199, 1956-2 Cum. Bull. 721, 740 (FUTA). *Pacific American Fisheries, Inc.* v. *United States*, 138 F. 2d 464, 465 (9th Cir. 1943); *S.S. Kresge Co.* v. *United States*, 379 F. 2d 309 (6th Cir. 1967). Compare *Commissioner* v. *Kowalski*, 434 U.S. 77 (1977).

portion of the Regulations provides as follows (Section 31.3121(a)-1(f), 26 C.F.R., (emphasis supplied)):[7]

> Ordinarily, facilities or privileges (such as entertainment, medical services, or so-called "courtesy" discounts on purchases), furnished or offered by an employer to his employees generally, are not considered as remuneration for employment if such facilities or privileges are of relatively small value and are offered or furnished by the employer merely as a means of promoting the health, good will, contentment, or efficiency of his employees. *The term "facilities or privileges", however, does not ordinarily include the value of meals or lodging furnished, for example, to restaurant or hotel employees, or to seamen or other employees aboard vessels, since generally these items constitute an appreciable part of the total remuneration of such employees.*

Given the breadth of the statutory definition of "wages" to include the "value of meals or lodging furnished * * * to * * * seamen or other employees aboard vessels * * *," the decision below correctly included the value of the meals and lodging in the employees' FICA and FUTA tax base in accordance with the command of the controlling Regulations. These Regulations were promulgated pursuant to specific congressional delegations of authority.[8] Since they are reasonable and consistent with the statute, the court

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[7]Section 31.3306(b)-1 of the Treasury Regulations on Employment Tax, which defines "wages" for FUTA purposes, is virtually identical.

[8]The legislative delegations with respect to the tax provisions were contained in Sections 808, 908 and 1102 of the Social Security Act of 1935 (49 Stat. 638, 643, 647). Section 1102 is now codified as 42 U.S.C. 1302. Sections 808 and 908 were reenacted respectively as Sections 1535 and 1609 of the Internal Revenue Code of 1939 (26 U.S.C. (1952 ed.)). In the Internal Revenue Code of 1954, Sections 808 and 908 were not retained

of appeals correctly upheld the validity of the Regulations. *Thor Power Tool Co.* v. *Commissioner*, 439 U.S. 522, 533 n.11 (1979); *National Muffler Dealers Ass'n* v. *United States*, 440 U.S. 472, 484 n.19 (1979).

2. The issue of includability of employer-furnished meals and lodging in the employees' FICA and FUTA wage tax base presented here is essentially identical to the question presented in our petition for certiorari last Term (No. 79-742) in *Hotel Conquistador, Inc.* v. *United States*, 597 F. 2d 1348 (Ct. Cl. 1979), cert. denied, 444 U.S. 1032 (1980). There, the Court of Claims held that the value of meals furnished to hotel and restaurant employees for the employer's convenience was not includable as "wages" for FICA and FUTA tax purposes. In seeking review by this Court, we argued that the decision of the Court of Claims conflicted with *S.S. Kresge Co.* v. *United States*, 379 F. 2d 309 (6th Cir. 1967), and *Pacific American Fisheries, Inc.* v. *United States*, 138 F. 2d 464 (9th Cir. 1943). Accord: *S.S. Kresge Co.* v. *United States, supra*, 218 F. Supp. at 240. In those cases, the Sixth and Ninth Circuits ruled in comparable situations that the value of free meals furnished by employers is a part of the employees' "wages" for purposes of FICA and FUTA.

As we pointed out (at 8-10) in our petition for certiorari in *Hotel Conquistador*, we believe that this Court should resolve the conflict and establish a national rule with respect

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in separate sections. Instead, they were incorporated into Section 7805 of the Internal Revenue Code of 1954, without any change in meaning or scope. See H.R. Rep. No. 1337, 83d Cong., 2d Sess. A324-A325 (1954); S. Rep. No. 1622, 83d Cong., 2d Sess. 484 (1954). See *Goldsboro Christian Schools, Inc.* v. *United States*, 43 A.F.T.R.2d para. 79-473, at 872 & n.12 (E.D. N.C. Sept. 27, 1978), on appeal, No. 80-1473 (4th Cir.).

The legislative delegations respecting the benefit statutes were contained in Sections 205 and 1102 of the Act (49 Stat. 624, 647), which are now codified as 42 U.S.C. 405(a) and 1302.

to this common form of compensation for hotel and restaurant workers, and, as here, for other employees stationed in remote areas. The decision below demonstrates that since the Court's denial of certiorari in *Hotel Conquistador*, the conflict has persisted and, indeed, has become more explicit. We therefore submit that the Court should grant the petition in this case.

In *Hotel Conquistador*, the Court of Claims refused to follow the Sixth Circuit's decision in favor of the government in *S.S. Kresge Co.* on the ground that the court there "did not have * * * the benefit of the criteria to apply to regulations in this area, as prescribed in *Central Illinois* [*Public Service Co.* v. *United States*, 435 U.S. 21 (1978)]" (597 F. 2d at 1354). However, this Court's decision in *Central Illinois Public Service Co.* does not bear upon the question presented in this case. There, the Court held that an employer's reimbursement for 1963 lunch expenses of employees on nonovernight company travel did not constitute "wages" subject to withholding by their employer within the meaning of Section 3401(a) of the Internal Revenue Code of 1954.

Central Illinois Public Service Co. turned on the fact that the pertinent Treasury Regulations excluded from the concept of wages, for purposes of *income* tax withholding, amounts paid for travel or other business expenses without regard to whether the travel was away from home overnight. In these circumstances, the Court was reluctant to impose secondary tax liability on the employer by retroactively applying the overnight rule of *United States* v. *Correll*, 389 U.S. 299 (1967), to the year 1963 when "not one regulation or ruling required withholding on any travel expense reimbursement" (435 U.S. at 32). Here, by contrast, the Treasury Regulations and the published rulings extant during the year at issue unambiguously require the

inclusion of meals (and lodging) in the FICA and FUTA "wages" tax base. The Court of Claims therefore erred in concluding that *Central Illinois Public Service Co.* undermined the authoritative force of *S.S. Kresge Co.* v. *United States, supra.* As the court below succinctly put it in similarly distinguishing *Central Illinois Public Service Co.*, "[t]he factors considered [in that case] * * * do not decide that a purely prospective regulation, suffered for forty years by a Congress acutely attuned to tax considerations, is invalid" (Pet. App. 10a; footnote omitted).

The Seventh Circuit, however, has aligned itself with the Court of Claims. In *Oscar Mayer & Co.* v. *United States*, 623 F. 2d 1223 (1980), that court held that an employer's furnishing company-owned cars for the personal use of employees at less than cost did not constitute "wages" for FICA and FUTA purposes. In so ruling, the court relied upon this Court's decision in *Central Illinois Public Service Co.* and the discussion of that case by the Court of Claims in *Hotel Conquistador* for the proposition that the term "wages" should be construed identically for income tax withholding and for FICA and FUTA tax purposes (see 623 F. 2d at 1226-1227).[9]

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[9] *Royster Co.* v. *United States*, 479 F. 2d 387 (4th Cir. 1973), which petitioner cites (Pet. 5, 7, 9), does not conflict with the decision below. Rather, the principal question presented in that case was the same as in *Central Illinois Public Service Co.* In *Royster Co.*, the court held that payments for noon meals consumed by salesmen engaged in nonovernight travel were not "wages" under Section 3401(a) for purposes of *income* tax withholding. Since the FICA and FUTA Regulations with respect to such travel reimbursements were identical to the income tax withholding Regulations, the Court further held them to be excludable from the FICA and FUTA "wages" base. Here, however, the meals and lodging involved are of a non-travel character that are governed by different Regulations. Indeed, a district court in the Fourth Circuit has held that lodging furnished by an employer to its employees without charge is includable in the employees' FICA and FUTA wage base. See *Goldsboro Christian Schools, Inc.* v. *United States, supra.*

3. It is therefore clear that *Hotel Conquistador* did not put to rest the conflict among the lower courts with respect to whether meals, lodging and other fringe benefits furnished to employees are part of their "wages" for FICA and FUTA tax purposes. That conflict has persisted. As matters now stand, the Fifth Circuit in the decision below, and the Sixth and Ninth Circuits have held that such benefits are so includable, while the Court of Claims and the Seventh Circuit have ruled they are not. Moreover, there is explicit disagreement among the court below, on the one hand, and the Court of Claims and the Seventh Circuit, on the other hand, as to whether this Court's decision in *Central Illinois Public Service Co.* has any bearing on the FICA and FUTA tax question presented here. This Court should dispel the confusion among the circuits and establish a uniform definition of "wages" for employee fringe benefits such as meals, lodging and the like, for the benefit of employers, employees, and the Treasury.

Indeed, the need for resolution of the conflict is underscored by the growing administrative importance of the question. In our petition in *Hotel Conquistador* (at 9-10) filed in November 1979, we stated that there were then 630 cases pending at the audit and appellate administrative levels involving the meals-as-wages issue, with $11,544,720 in FICA and $739,077 in FUTA taxes at stake. During the past year, the revenue involved has substantially increased. We are advised by the Internal Revenue Service that there are now 622 cases pending in the audit and appellate levels with $17,443,953 in FICA and $544,443 in FUTA taxes at stake, and 19 cases pending in litigation. Moreover, there are presently 15,011 FICA and FUTA refund claims pending in the total amount of $12,375,969.[10] These figures

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[10]The Service further advises that these figures do not include refund claims that do not compute the particular amount at issue but simply claim all amounts due and owing.

appear to confirm the prediction by the national tax director of a major accounting firm that the decision of the Court of Claims in *Hotel Conquistador* "will spawn more refund claims than any [decision] I've seen in 15 or 20 years * * *" (Wall Street Journal, May 1, 1979, at 1).

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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